The Tennessee Advisory Commission on Intergovernmental Relations

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MEMORANDUM

TO: TACIR Commission Members

FROM: Harry A. Green
Executive Director

DATE: September 8, 2011

SUBJECT: Update on the Impact of Changes in the Structure of the Tennessee Valley Authority on its Payments in Lieu of Taxes to the State of Tennessee and its Local Governments

In 2009 the Tennessee General Assembly passed the Electric Generation and Transmission Cooperative Act to permit the creation of non-profit cooperatives to sell electric power to Tennessee Valley Authority (TVA) distributors. The bill instructed the Tennessee Advisory Commission on Intergovernmental Relations to monitor changes in the wholesale power supply arrangements between TVA and its municipal utilities and electric cooperatives to determine whether any such changes will impact TVA's payments in lieu of taxes (PILOT) to the state and its local governments.[1]

In November 2010 TVA reported that the PILOT in fiscal year 2011 would amount to $520 million dollars, as compared with $550 million for 2010. Of the $520 million total about 60% or more than $300 million will be paid to Tennessee. The reduction of nearly 5.5% in the total was attributable to some unusual weather conditions as well as the slowdown in economic activity associated with the national recession.

Thus far in 2011 TVA has announced a number of changes in its power generation system. First, in April of this year TVA agreed to a settlement with the U.S. Environmental Protection Agency to a plan to reduce its emissions of

[1] The Legislature was concerned that the bill created the possibility that such new entities could sell power directly to distributors rather than through TVA and effectively reduce TVA revenues with a subsequent reduction in the PILOT. Consequently, the original bill was amended to preclude that from happening.

pollutants. This settlement included the closing of 18 coal-fired generating units over the next six years as well as the expenditure of up to $5 billion on pollution controls to be installed at other coal-fired steam units. Among the units to be closed are six generators at the facility in New Johnsonville, Tennessee, two of four units at the John Sevier plant in Rogersville, Tennessee, and six of eight units at the Widows Creek facility in North Alabama.

Plans for shutting down older coal-fired generators had been under discussion for some time so that the expectation had existed well before the actual announcement. To replace the generation capacity being phased out TVA had already begun to acquire and to build new facilities utilizing combined combustion technology which employs natural gas and expand its existing nuclear power generation capability. In addition, TVA has plans for improving energy efficiency and utilizing alternative energy sources.

In June of 2011 TVA opened a new combined combustion unit at the Lagoon Creek facility near Brownsville, Tennessee to make eleven such facilities in the TVA System. And, in July the acquisition was announced of still another combined combustion facility in Ashland, Mississippi. Finally, a combined cycle unit is under construction at the John Sevier plant in Rogersville, Tennessee.

As mentioned, some months ago the TVA Board announced plans for the enhancement of its nuclear power capacity. Some of those enhancements are currently in progress while others remain in the planning stage. The catastrophe in Japan casts a shadow over these plans but historically construction and bringing to operation of nuclear power facilities takes considerable time.

At present power generation by alternative sources such as wind and solar provide only a very small percentage of TVA power and any wind-generated capacity is purchased from suppliers in the western United States. The Board's plan does include significant power savings through improved efficiency. That savings would be approximately the same as a large power generating facility. Keep in mind that energy savings means less power sold, lower revenues, and a lower PILOT, other things equal.

The ultimate impact of these changes on the amount and distribution of the PILOT available for the state of Tennessee and its county and municipal governments remains to be seen. There will certainly be changes in the future resulting from the developments described here, such as the closing of the New Johnsonville facilities which at some point could result in a decline of the payments received by Humphreys County, as well as other changes yet to be announced. See Figure 1 on page 4 for the methodology used to determine the PILOT distribution.

For the present all the new facilities are operated by TVA with only an ownership position held by the Seven States Power Corporation in the Southhaven, Mississippi facility in Mississippi. As a result there would be no impact on the PILOT from the sale of power through an entity other than TVA itself.

In conclusion it would be well to point out to all recipients of the PILOT that TVA revenue forecasts for the foreseeable future are for increases in its revenues averaging one to two percent annually. In other words, they can count on the PILOT for the future but should not expect large increases in the future as they have sometimes experienced in past years.

Procedure for Allocating Payments in Lieu of Taxes

Payments in lieu of taxes are mandated by the 1933 TVA Act which states that 5% of the agencies "gross proceeds" will be paid to states and local governments where the agency owns and operates property. The term gross proceeds is interpreted, by TVA, to mean its operating revenues from the sale of power to municipalities, cooperatives, and industries but excludes any sales directly to federal agencies.

Of the total payments a relatively small amount, less than 1%, is paid directly to local government. According to the TVA Act, payments made directly to counties are the 2-year average of ad valorem property taxes on power properties and reservoir land associated with power production.

Payments made to Tennessee in lieu of taxes received from TVA are apportioned between the state and local governments as shown in Figure 1 on the following page. (Under Tennessee Code Annotated, Title 67, Chapter 9, Part 1)

Figure 1. Tennessee Valley Authority (Tennessee State Revenue Sharing Act)

Title 67, Chapter 9, Part 1

From the Allocation of TVA Payments in Lieu of Taxes to Tennessee
(after direct payments to counties[2] and 1977-78 base payment to state, counties and cities[3])

	Basis of Apportion-ment *(§ 67-9-101)*	**Proration to Counties & Municipalities** *(§ 67-9-102)*
Paid to areas with TVA construction[4] *(remainder allocated to CTAS, TACIR and Four Lakes Regional Development Authority)*	3%	
Retained by the State[5]	48.5%	
Paid to Local Governments[6]	48.5%	
Counties—70% of Local Share		
• *Based on Percent of State Population*		*30% (14.55% of total)*
• *Based on Percent of State Land*		*30% (14.55% of total)*
• *Based on County's Percent of TVA Acreage in Tennessee*		*10% (4.85% of total)*
Municipalities—30% of Local Share[7]		

In the case of Humphreys County where TVA has announced the closing of six coal-fired units only 10% of its allocation is based on TVA acreage in the county. At worst that would the loss to the county if TVA ultimately sold all of the land it currently owns there. The direct payments to the county amount to less than 1%, or something more than $10,000, of the allocation from the state. It should be emphasized that there will be no immediate impact of the announced closing on Humphreys County's payments from TVA as the closing will occur over several

[2] $2,167,755 in federal fiscal year 2010.
[3] $55,204,586.
[4] Construction activity on facilities to produce electric power.
[5] Less amount required to guarantee Four Lakes 0.3% of total funds allocated ($780,663 in state fiscal year 2010) per Tennessee Code Annotated § 67-9-102(b).
[6] Less $107,088 to TACIR per Tennessee Code Annotated § 67-9-102(a)(3) and amount required to guarantee CTAS 0.9% of total funds allocated and TACIR 1.2% of total funds allocated per Tennessee Code Annotated § 67-9-102(b)(3) ($1,131,962 for the two combined in state fiscal year 2010).
[7] Payments to incorporated municipalities are based on the percentage that the population of that municipality bears to the population of all incorporated municipalities in Tennessee.

years plus TVA has made no announcements regarding the property that it owns in the county.